

Presentation

on

Statement of Cash Flows (Chapter-13) & Sole trader and partnership financial statements (Chapter-14)

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Statement of Cash Flows (IAS 7)

- ✓ The statement of cash flows shows movements in cash and cash equivalents.
 - ✓ All entities are required to produce a statements of cash flows.
 - ✓ The statement of cash flows concentrates on the sources and uses of cash and is a useful indicator of liquidity and solvency.
 - ✓ Cash and cash equivalents: Short-term, highly liquid investments that are readily convertible to known amounts of cash which are subject to an insignificant risk of changes in value(maturity of three months or less from the date of acquisition.
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- ✓ Method:
 - ✓ Direct Method
 - ✓ Indirect Method
 - ✓ Key difference between direct and indirect method on operating activities.

Sales	100 Cr
<u>Less Expenses</u>	<u>60 Cr</u>
Profit	40 Cr

Cash Generation?

Cash = Profit = 40 Cr

Cash > 40 Cr

Sales	100 Cr
<u>Less Expenses paid</u>	<u>30 Cr</u>
Cash	70 Cr

Loan repaid	50 Cr
<u>Machinery purchase</u>	<u>10 Cr</u>
Cash	10 Cr

Cash < 40 Cr

Sales	70 Cr
<u>Less Expenses paid</u>	<u>60 Cr</u>
Cash	10 Cr

Loan raised	40 Cr
<u>Sales of Assets</u>	<u>20 Cr</u>
Cash	70 Cr

Two Method:
 1. Direct Method
 2. Indirect Method

1. Cash flow from Operating activities
 2. Cash flow from investing activities
 3. Cash flow from financing activities

Sole trader financial statements

- ✓ Sole trader financial statements are similar in terminology and format to those of companies prepared under on-IFRS but there are important differences.
- ✓ Tax is not included in sole trader accounts, and there is no formal requirements as to headings in the profit and loss account.
- ✓ The ownership interest half of the statement of financial position shows opening capital, plus capital introduced, less drawings, plus profits, less losses to arrive at the closing net assets figure at the Statement of Financial Position date.

Partnerships

- ✓ A partnership is a business run by two or more people together; it is not a separate legal entity so tax does not appear in the accounts.
- ✓ Parties agree how to appropriate the profits made by the business each year. Sometimes there are salaries, and there is always a profit sharing ratio (PSR).
- ✓ A partnership is an arrangement between two or more individuals in which they share the risks and rewards of a joint business operation, as if they were joint sole traders.

Why would a sole trader wish to register as a limited liability company?

- ✓ A sole trader with a successful business may wish to register the business into a company, so that it is a separate entity. The usual motivations for such a step are:
- ✓ To gain the protection of limited liability for the sole trader, so that he/she is no longer personally liable for the business's debts
- ✓ To make raising of capital easier, as any new investors will receive shares in the business
- ✓ To take advantage of certain tax concessions for companies
- ✓ To appear more established in the eyes of the world Operationally, becoming a company need make no difference to the business, except that there is more need for compliance with regulations, and greater publicity.

We shall assume that on becoming a limited liability company:

- ✓ The sole trader becomes the sole shareholder
- ✓ The company prepares financial statements under IFRS

The partnership agreement

- ✓ A partnership agreement contains the terms of the partnership, in particular the financial arrangements between partners and how profit/loss should be appropriated. It should cover the following issues.
- ✓ **Capital.** Each partner puts in a share of the capital. Any minimum fixed amount should be stated.
- ✓ **Interest on capital.** Partners can pay themselves interest at an agreed rate on the capital they put into the business. This is treated as a profit appropriation.
- ✓ **Partners' salaries.** Partners can pay themselves salaries. These are not salaries in the same way that an employee of the business is paid a wage or salary; **partners' salaries are an appropriation of profit, and not a profit and loss account expense.** Paying salaries gives each partner an income before **the residual profits** are shared out
- ✓ **Profit-sharing ratio (PSR).** Partners can agree to share residual profits and losses after interest and salaries in any profit-sharing ratio they choose. For example, three partners might agree to share profits equally, but if one partner does a greater share of the work, or has more experience and ability, or puts in more capital, the ratio of profit sharing might be different.
- ✓ Profit-sharing ratio (PSR). Partners can agree to share residual profits and losses after interest and salaries in any profit-sharing ratio they choose. For example, three partners might agree to share profits equally, but if one partner does a greater share of the work, or has more experience and ability, or puts in more capital, the ratio of profit sharing might be different.

The partnership agreement

- ✓ **Guaranteed minimum profit shares.** Partners can agree that one or more partners should get a guaranteed minimum profit share, even if the partnership makes a smaller than expected profit, or a loss. If the amount allocated by using salaries and the profit-sharing ratio (PSR) is lower than this, the partner receives the guaranteed minimum profit share and the remaining profits are shared between the other partners in the profit-sharing ratio. Occasionally, one partner will guarantee another partner's minimum profit share. That partner will alone make up the difference.

Agreement set down in the Partnership Act 1932

If there is no formal agreement between the partners, certain rules laid down by the Partnership Act 1932 are presumed to apply instead.

- ✓ Profits are shared equally between the partners
- ✓ There are no partners' salaries
- ✓ Partners receive no interest on the capital they subscribe to the business and pay no interest on drawings
- ✓ Partners are entitled to interest of 6% per annum on any amounts they advance to the business in excess of subscribed capital, such as a loan.

*Thank
you*

